City of Lincoln Nebraska
Police and Fire Pension
Summary for 08/12/99 Advisory Committee Meeting

Members Present: Dennis Duckworth, Alan Townsend, Al McCray, Jim George, Aaron Drake.
Members Absent: Ross Hecht
City Staff: Georgia Glass, John Cripe, Paul Lutomski
Others: Jeff Gottbreht,

Dennis Duckworth: Meeting is called to order. Motion to approve the May minutes?

Al McCray: So moved.

Alan Townsend: Second.

Dennis Duckworth: All in favor?

Dennis Duckworth, Alan Townsend, Al McCray, Jim George, Aaron Drake: Aye.

Dennis Duckworth: Opposed? (silent) Motion carries. Recent activities Paul?

Paul D. Lutomski: Item B: No security transaction since last meeting. Item C: Mayor Wesely approved attaining 30% Equity Allocation over the next two years. A plan to implement this investment will be discussed in the **Investment Strategy** section of today's meeting.

John Cripe: We made the request in May and heard back just a couple days ago.

Paul D. Lutomski: The white 3-ring binder is a copy of the information given to the mayor on May 25th. Item D: The City's budget office initially listed a $200,000 increase be considered for the pension budget. Mayor Wesely's final budget proposal contained a $41,198 increase, mostly due to the addition of 8 Police Officers. Recently the City Council changed the budget to add 6 Police Officers and changed the pension's budget increase to 6/8th of $41,198, or $30,898. Currently the budgeted City contribution to the pension is to increase from $835,616 to $866,514.

John Cripe: I told them at the budget hearing in May that if they add any additional staff they should add 12.27% of salary for the new employees in addition to the $200,000. They didn't have any questions. I talked about the need to increase funding over the next few years. I didn't hear anymore about it until Jim (George) called us about the newspaper's budget article.

Dennis Duckworth: So we lost the $200,000 but did get the 12%?

Paul D. Lutomski: Yes. I talked to Steve Hubka and he said that was what the increase represented.

Jim George: It was my understanding he agreed the $200,000 was a good idea.

John E Cripe: Yes, as did the previous mayor. I explained this to the budgeting committee right after Mayor Wesely took office, and I asked for the increase if they were going to add additional Police Officers.

Jim George: Do you know if the Finance Director recommended the $200,000?

John E. Cripe: By the time he got onboard in late July, I think it was already decided.

Jim George: Was it decided by the Mayor, or the City Council?

Paul D. Lutomski: Steve said the budget presented to the council did not contain the $200,000, only the $40,000. Steve said the $200,000 was on the original list of considerations but did not make the final Mayor's budget proposal to the council. That was as much as he wanted to elaborate.

Dennis Duckworth: I would assume baseball got in the way of pension funding.

John E. Cripe: I don't know. This is a long term problem. Current normal costs are about $2.5 million annually. Our goal was to increase annually to about get to normal cost. I thought we were making progress last year when it almost doubled, and I was assured by budget that it would get an additional $200,000 for each of the next five years. This puts us behind.

Paul D. Lutomski: Before we talk about the next item, the actuarial experience study, for the benefit of Georgia (Glass), Jeff (Gottbreht), and Dave (Engler) I'll explain about the DROP.

John Cripe first heard of a DROP at a pension conference. A DROP is best suited to a traditional style defined benefit plan, like the 8% plan, that does not offer a lump sum refund. DROP is an acronym for Deferred Retirement Option Plan. It is a way for a defined benefit plan member to accumulate a lump sum for retirement. A member would enter our DROP and retire as far the pension plan is concerned, but not retire and keep working as far as their department is concerned, for up to three years. The member's monthly pension benefit is deposited into their DROP account. They self-direct the funds with a third party company. When the member retires-in-fact their same monthly pension is paid to them, rather than their DROP account. If the member gets a pay raise their pension benefit does not increase because they are retired as far as their pension is concerned. If a member becomes disabled, they do not get disability pension benefits because they are retired as far as their pension is concerned, but since they are leaving service their monthly pension is paid directly to them rather than to their DROP account.

There are three different pension plans. All the plans offer early retirement at age 50 and 21 years of service. The 7% and 7.6% plans offer a refund of the members accumulated contributions and interest when the member retires. The monthly annuity is actuarially reduced by the amount of the refund. The 8% plan does not pay a refund. If a 7% or 7.6% plan member wanted to enter the DROP the member would have to leave their account value with the City.

We received a DROP cost estimate from our actuary firm and the cost was not neutral. In fact it was about $5 million initially plus about a1% increase to normal cost for each year in the future. We talked with them regarding how to get the DROP cost closer to neutral. Their suggestion was to first perform an experience study. An experience study will give use results on rates of retirement, resignation, quits, disabilities, deaths, salary increases and return rates - all the assumptions that are used to generate the annual actuary report. This had not done in a long time and it would provide an accurate foundation upon which to base the DROP costing. Once the study was done, and agreement was reached regarding which experience study assumptions to implement, tweaks to the DROP design could be discussed and a new DROP cost estimate generated.

According to our actuary, the changes proposed in the Experience Study won't effect DROP costing very much.

The study looked at withdrawal rates for different groups of employees. Members were grouped by Police and Fire and by age brackets, but there was not enough data to break by plan A, B and C (8%, 7.6% and 7% respectively). The administration agrees with all proposed withdrawal experience changes in section "C" except that withdrawal rates for Police Officers with less than 5 years of service should remain at the higher present rates. The reason for this is that the experience the actuary had ended 8/31/98 and we have had quite a few Police under 5 years of service withdraw since then. Adoption of the proposed withdraw rates will increase the pension's Normal Cost.

The actuary proposed changing the asset valuation method. Administration agrees to the change in asset valuation method as proposed on page E-3. The proposed method provides for a smoother year to year actuarial valuation, which in turn facilitates less drastic fluctuations in the recommended City contribution to the pension.

According to our actuary, the combined effect of adopting the proposed withdrawal experience changes (except as noted) and adopting the new valuation method will be to decrease over funding by approximately 25%.

However, because Mayor Wesely has approved a 30% equity allocation, an offsetting change in the pension's assumed long term interest rate is reasonable. The experience study proposes increasing the pension's investment return assumption by 0.5%, to 7.5%. According to our actuary, even if the mayor didn't approve the 30% allocation this change would still be reasonable. This change would approximately restore the over funding lost as a result of adopting the other proposals.

Even though there was not enough experience to justify a separate Retirement Experience schedule for Plan A members versus Plan B and C members, we discussed (with the actuary) the fiscal impact of adopting the following retirement withdrawal schedule for Plan A members.

Age	Proposed
50	.5
51	.35
52	.25
53	.25
54	.15
55	.05
56	1.00

From our (administration's) understanding the adoption of this separate Plan A schedule would lower the DROP cost estimate. Since Plan A is the major cost factor we wanted to investigate this even given the possibility nothing would become of it.

According to the actuary, if this separate Plan A retirement withdrawal schedule were to be used, the DROP cost would be dramatically lower, because the normal cost to operate Plan A would be "significantly" higher (thereby decreasing the difference in cost between the two). Also, the cost to allow another opportunity for members on Plan B or C to switch to Plan A would be significantly higher, again because of the higher normal cost of Plan A. For these reasons, and the fact there was no evidence to support the schedule, it will not be adopted.

After talking with our actuaries we are proposing the following DROP costing ideas.

Alternative #1: Have the plan's actuary re-cost the DROP to include the following items.

1. Adopting the proposed "earlier" withdrawal schedules will increase normal cost, but increasing the investment return assumption will approximately offset that cost. Because the withdrawal schedule is earlier, the difference (in years and days) between expected retirement and DROP entry is decreased
2. Change DROP eligibility for Plan A members to match "All Other Plans" eligibility to lower the DROP cost estimate.
3. Do not pay the COLA during the DROP period to reduce the DROP cost estimate. The rational is that the member is still actively employed, and therefore receiving salary increases to offset the effects of inflation. This change will lower the estimated cost of the DROP.

Alternative #2: Have the plan's actuary re-cost the DROP per Alternative #1 and determine the reduced members benefit percentage necessary to attain a neutral DROP cost estimate.

Alternative #3: Have the plan's actuary re-cost the DROP per Alternative #1 changing the design to revoke self-directed investment of DROP assets, and replace it with a fixed rate of interest. Have the actuary determine the fixed rate of interest necessary to attain a neutral DROP cost estimate. The rate should be tied to the pension's assumed rate of return. For example, if the fixed rate was 7% and the assumed rate of return was 7.5%, the fixed rate is set at 93.3% of the assumed rate. If the assumed rate were to increase to 8% the DROP fixed rate would increase to 93.3% of that, or 7.464%.

Jim George: I don't like alternative 3. I thought the funds were to be self-directed.

John E. Cripe: I don't like it either. I think it is important for the employees to be able to self-direct their DROP assets. This may be unacceptable. If we ask the actuary what the percentage is, as in alternative 2, we will know what it takes to get to neutral cost and can decide if we are interested in that plan design.

Jim George: Why wasn't the early retirement option omitted for Plan A, B, and C members? That would decrease the DROP cost.

John E. Cripe: That would make some difference in the cost for Plan A. We can add that to our list of changes and costs. We'll consider any changes.

Jim George: Will that be added to alternative 1?

John E. Cripe: Lets eliminate alternative 3, keep alternatives 1 and 2, and add new alternatives 3 and 4 that require normal age and service retirement for Plan A members. Can the committee make a motion to proceed?

Jim George: I'll make a motion to proceed.

Aaron Drake: Second.

Dennis Duckworth: Discussion? (Silence) All in favor?

All: Aye

Dennis Duckworth: Motion carries. How long will it take to get a report?

John E. Cripe: Certainly by the next meeting. If we have it before then we'll ship it out to you. I'd like to get this going as soon as possible. Maybe we can have a meeting in October instead of November.

Paul D. Lutomski: The actuary said it should be a lot quicker now that the basics of the computer costing program are done.

Jim George: Are we going to have a special meeting when to DROP costing is done?

John E. Cripe: If you want us to work with Dennis to set up a special meeting we will be glad to.

Paul D. Lutomski: Next is Investment Strategy. Cash Flow Estimate for the next 12 months shows no funds are expected to be available for investment. Our recommendation is to implement the Equity Investment Proposal. I'll hand that out now. This document was prepared for Mayor Wesely.

Back in 1993 the Pension's Administration and Advisory Committee agreed funds should be "dollar cost averaged" to attain a 30% Equity / 70% Debt asset allocation in approximately two years. It was also agreed, once the 30% level was attained a higher equity allocation would be considered.

Reasons for this plan were:

- ❖ 30% Equity / 70% Debt allocation provides the lowest risk (of any mix on the efficient frontier) and also increases return potential over the existing 100% debt allocation.

- ❖ The Pension's Long Term Risk/Return Indifference Curve intersects with the efficient frontier at a point indicating an approximate 50% to 60% Equity allocation. (Paul draws on whiteboard)

- ❖ Most defined benefit plans have a significant allocation to equities. (According to a 1996 Greenwich Associates study the average equity allocation, of defined benefit plans of Municipalities and Cities with assets from $101 to $250 million, was 54.1%)

- ❖ Any investment fund's performance is determined 91.5% by asset allocation, 1.8% by market timing, 4.6% by security selection, and 2.1% by other factors. (*Financial Analysts Journal,* May-June 1991)

- ❖ Portfolio risk decreases as asset class diversification increases.

Potential benefits of a 30% / 70% allocation:

- ❖ Less risk.
- ❖ Higher return.
- ❖ Less tax dollars required.
- ❖ Protection against a sustained period of low interest rates.
- ❖ Enhance ability of plan to handle an expanding work force.

Aaron Drake: And it only took us six years to get approval.

Dennis Duckworth: And the stock market went down for those six years.

John E. Cripe: We should point out why we weren't in the market earlier. We report to the Personnel Director who reports to the Mayor. If the Mayor says 5% equity maximum then we do 5%. We had to point out to Mayor Wesely why we were at such a low percentage.

Paul D. Lutomski: A nationwide RFP process was used to select Washington Mutual Investors Fund and The Investment Company of America from The American Funds Group, and the Index 500 Fund from The Vanguard Group. It was the Pension Administration, and the Advisory Committee's intention to use the equity mutual funds provided by The American Funds Group and The Vanguard Group to attain the 30%.

Mayor Johanns restricted the plan's equity allocation to 5%, which was reached in 1994. After being approached several times, in 1996 the Mayor allowed the pension to make an additional $1 million equity investment. The last time this issue was discussed with Mayor Johanns was May 21, 1997. He agreed to allow the pension to keep all its equities (9.5% allocation) and any growth from the current base, but made it clear he would not allow any new investment.

Since 1993 we have updated our information and therefore updated the plan. The updated info is:

- ❖ The lowest risk equity portfolio has a ratio of 60% domestic and 40% foreign equities.

- ❖ Indexed equity management is likely to outperform Actively Managed equity investment over the long term. The rational is that both groups own the entire market, but active managers buy and sell so they incur more trading costs and therefore must, on average, earn a lower total return than index managers who do not trade as frequently.

- ❖ Equity funds managed under a Value Style are likely to outperform equity funds managed under a Growth Style.

The Equity Allocation Plan is:

Equities currently comprise 12.5% of the total portfolio, therefore at the plan's current $125 million valuation, an additional $21.875 million will need to be invested.

Funds offered by the American Funds Group and The Vanguard Group were examined to create a list of funds to be considered. In order to be considered a fund must; 1) provide access to a sector of the investment universe that is not covered by funds currently held by the pension, or 2) split a sector already covered by the pension, to provide more allocation control.

From The American Funds Group, AMCAP Fund was considered because it targets Domestic Mid-cap value style stocks. New Economy was considered because it targets global Services and Information Companies.

From the Vanguard Group, The Emerging Markets, Pacific, European, and Total International Indexes were considered because the pension currently has no exposure to foreign indexes. The other indexes listed split an area already covered by indexes owned by the pension, to provide more allocation control.

Using the currently held funds, and the funds to consider, Pension Administration developed a decision science program to invest $21.875 million. Fund Names preceded by an "A:" are in the American Funds Group, and those with preceded by a "V:" are in The Vanguard Group. Currently held funds are not highlighted. Funds considered for selection are highlighted in yellow.

Micro-Soft Excel has a function called solver, which is basically a decision science optimization program. For equity allocation the Goal was to Maximize static 5 year total returns derived from averaging each fund's actual 5 year annualized return and asset class return (less expense ratio) from Ibbotson Associates. We chose 5 years because we thought 10 years was too long, and returns were available for most funds for 5 years. This was an iterative process that made more sense to maximize returns and use risk as a constraint, rather than the other way around.

Al McCray: Are the returns adjusted for currency translation?

Paul D. Lutomski: Yes, they are based on U.S. dollar returns. The asset class returns were 13.2% for international, 10.2% for large-cap domestic, and 12.2% for small-cap domestic. The blended return figures are an average of the mutual fund's real 5 year average annual compound return less expense ratio, and the asset class return. I should explain a little about Total International Stock index since has not been in existence for 5 years. It's 5 years real type return is a blend. It is comprised of three funds that have been around. It is 8.5% of the Emerging Market Stock Index, 65.1 % of the European Stock Index and 26.4% of the Pacific index. I took returns from those three funds and the weightings to calculate the Total International Index return.

<u>Constraints were:</u>

- ❖ Each fund's **New Money** amount must be greater than or equal to the negative of the fund's **Market Value.** In other words no more than the existing holdings can be sold, but any positive amount, up to $21.875 million, may be purchased.
- ❖ The total of the Weighted Average **Expense Ratio** must be as close as possible to the current 42.387 basis point annual expense ratio. (in other words must be minimized)
- ❖ **Fee $ + Expense $ for 5 Years** must be less than or equal to $1,000,000. (in other words it must be minimized) This method is a way to look at longer term expenses.
- ❖ The value of **Domestic** equities must be less than or equal to 60%. (Thereby forcing the value of **Int'l** (International) equities to be greater than or equal to 40%)
- ❖ The value of **Index** equities must be greater than or equal to the value of **Active** (Actively Managed) equities.
- ❖ The value of **Value** (Value Style) equities must be greater than or equal to the value of **Growth** (Growth Style) equities.

I have numbered and included the final progression of iterations that got to the final figures. This is not all the runs. I spent the better part of a week on this.

John E. Cripe: Can we skip to the end?

Paul D. Lutomski: Sure.

We plan to dollar cost average equity purchases over a two year period.

The second to last page of the equity proposal shows the final allocations. Pages prior to this are iterations showing the progression to get to the final and supporting documentation.

The first column lists all the funds. There are notes behind the fund name if the fund has a sales charge, or if expense ratios decrease at a certain point. For example, Total Stock Market Index expense ratio decreases from 20 basis points to 10 basis points when the value of the fund is above $10 million. The second column lists each fund's market value on July 30, 1999. The third column shows sales, in parenthesis, and purchases of new equities. There is a zero in the first row, which corresponds to Washington Mutual. We are not buying anymore of that. The next one down, Investment Company of America has a total new investment amount of $1,250,000 (Lists each fund and sale, or purchase, through New Economy Fund)

The program sold all of the Index Trust 500 and Extended Market Index Fund, because those two funds combined contain the same stocks, albeit not in the same proportions, as the Total Stock Market Index. Also, Total Stock Market Index reached an expense ratio break point at $10 million.

To fund the new equity investment, debt securities will be sold and proceeds will be wired to The Vanguard Group and the American Funds Group and placed in a money market account until the transfers occur on the 15th of the month. Enough debt securities, to provide funds for three months of equity purchases ($2.74 million) will to be selected for sale at each advisory committee meeting.

Investment in the Total Stock Market Index Fund is a special situation. Part of the total will be provided by transferring shares from the Index Trust 500, and Extended Market Index, to the Total Stock Market Index. These two funds, if combined, would contain exactly the same stocks as the Total Stock Market Index, but in different amounts.

I mentioned earlier that Total International Stock index since has not been in existence for 5 years and that the 5 year return used for it was a blend of the Emerging Market Stock Index, the European Stock Index and the Pacific Index. The Total International Stock index has an expense ratio of .5%, and the expense ratios of the funds used to make it are 1% for the Emerging Market Stock Index, .5% for the European Stock Index and .5% for the Pacific Index. Since the Total International Stock index has an expense ratio of .5%, you can see it has a better expense ratio than the weighted blend of the other three indexes.

The next fund we plan to use is Vanguard's Growth Index. The two year amount is $1.25 million. The return for this fund was spectacular at 31.72% average for each of the last five years. Averaging that with the Ibbotson long-term asset class return of 9.98% resulted in 20.85%. This was the highest averaged return of any of the funds considered, so the program tried to use it up to the point were the value style versus growth style constraint stopped it.

Finally we plan to use Vanguard's Value Index. The two year amount is $1.17 million. The return for this fund was 23.51% average for each of the last five years. Averaging that with the Ibbotson long-term asset class return of 9.98% resulted in 16.75%.

Any questions?

John E. Cripe: This all leads to the parameters at the bottom of the table.

Paul D. Lutomski: Yes. We should go over that. Before this program the pension had 8 funds and after it will have 12 funds. The weighted average of the 12 funds' expense ratio comes to .42937%. The current weighted average for the 8 funds is .42387%. The constraint shows 1.42387%. The program was set to minimize the expense ratio to be as far below 1.42387% as possible while meeting the other constraints and maximizing the goal.

The previous column, "Investment Fee," shows the only fee is $50,000 for the $10 million to be invested in the Total International Stock Index. The Column totals Investment Fee plus expenses for a five year period. To get the listed figure, the expense ratio was turned into a dollar amount and multiplied by 5 years, and then the Investment Fee was added. The constraint shows $1 million. The program was set to minimize the Fees plus expenses while meeting the other constraints and maximizing the goal.

The location constraint was that the value of Domestic equities must be less than or equal to 60%. The end result was 59% domestic and 41% international.

The passivity constraint was that the value of Index equities must be greater than or equal to the value of Active equities. The end result was 62% passive and 38% actively managed.

The style constraint was that the Value equities must be greater than or equal to Growth equities. I just now noticed, the end result was 49% value and 51% growth. Initially it was a 50/50 mix, but when I rounded the investment dollar amount to the nearest $1000 the mix changed to 49/51. I can switch some money from growth to value and meet the 50/50 constraint.

Capitalization did not have any constraints, but is listed for your information.

John E. Cripe: The return figures are at the bottom.

Paul D. Lutomski: I wouldn't count on that figure as something the pension would actually earn over the next five years, but it is a relative measure that can be used to find the highest returning mix while staying within the constraints.

Jim George: Is this going to be continually adjusted as return rates change.

John E. Cripe: Do you mean are we going to rebalance?

Jim George: Yes.

John E. Cripe: No. Not until we complete the plan in two years. We expect some fluctuations while we dollar cost average. Once we get to 30% equities, we can re-evaluate if we should rebalance.

Paul D. Lutomski: I agree we should wait two years, then we could rebalance each year. The last page is our plan on how to implement the plan.

The equity purchases will be dollar cost averaged over a two year period. This is a total of $911,458.33 of new equity investment each month.

For example, Investment Company of America has a total new investment amount of $1,250,000. Each month $52,083.33 would be invested on, or about, the 15th of the month.

To fund the new equity investment, debt securities will be sold and proceeds will be wired to The Vanguard Group and the American Funds Group and placed in a money market account until the transfers occur on the 15th of the month. A sufficient quantity of debt securities, to provide funds for three months of equity purchases ($2.74 million), will to be selected for sale at each advisory committee meeting.

Investment in the Total Stock Market Index Fund is a special situation. $10,000,000 is the total investment amount over the 24 month period, resulting in a monthly amount of $416,666.67. However, part of the total will be provided by transferring amounts in the Index Trust 500 and Extended Market

Index. These two funds, if combined, would contain exactly the same stocks as the Total Stock Market Index, but in different amounts. In the first month 1/24th of each fund will be transferred, with the remainder provided from debt asset sale proceeds. In the second month 1/23rd of each fund will be transferred, with the remainder provided from debt asset sale proceeds, etc.

To pay for this we will sell some debt securities. Wire enough money to American and Vanguard to make the monthly purchases. For each three month period this would be $2.74 million. I was thinking that at each Advisory meeting I could present some securities that could be sold and the committee could help decide which securities should be sold. If something changes and it doesn't make sense to sell the selected the securities we should sell what makes the best sense. Right now it makes sense to sell Teasuries, rather than agencies, because spreads are so high. I would suggest selling some treasury STRIPs to pay for the first three months.

John E. Cripe: Regarding balancing, if the stock market does what it has been doing, and our earnings are much better than projected, we may be at 30% sooner.

Paul D. Lutomski: Or it might take longer.

John E. Cripe: Yes. We could reach 30% sooner than 2 years, or longer than 2 years.

Dennis Duckworth: I'm concerned there is a $50,000 expense. Have we looked at other funds? Or are we saying we are only going to consider the same companies we looked at several years ago? I'm concerned a $10 million investment it costs $50,000.

John E. Cripe: Years ago we did an RFP (request for proposal) when we decided to go to 30/70. If we were to do another RFP it could be 6-8 months before we make an investment. It seemed logical to use the fund companies we had originally intended to use to get to 30/70. Originally the fund companies were chosen with the idea of a 30/70 mix. Each has a large number of funds to choose from.

Dennis Duckworth: Couldn't we double up on the Total Stock Market Index fund and do nothing into the Total International Fund until we find something that has a lower expense ratio?

Paul D. Lutomski: We could, but if you want to meet the constraints that won't work. To avoid the sales charge … well look at EuroPacific Fund. It has no sales charge, so you are saving the .5% but the expense ratio is .86%.

John E. Cripe: We ran dozens of scenarios.

Paul D. Lutomski: If you take the .5% plus is it 22, or 24?

Dennis Duckworth: 34.

Paul D. Lutomski: In the first year you're ahead 84 to 86 with vanguard, and after that you only pay 34.

Dennis Duckworth: Yes, I'm asking if there other options that will allow us to move into equities at the same rate. Maybe not at what you think is the mix that we need, right away, but see if there is something out there that might have a lower overall expense. $50,000 is a big hit to pass it by without consideration. That's like somebody with 10 years on that takes their money out of the plan.

John E. Cripe: $50,000 isn't big for a $22 million investment.

Georgia Glass: What are the chances of coming up with opportunities that could cost less?

Paul D. Lutomski: This question is the reason for the 5 year fee plus expense ratio numbers. First year you're ahead 84 to 86, and after that you only pay 34 instead of 86. Index funds are going to be cheaper than actively managed funds, and among index funds Vanguard is the recognized industry leader for low costs. They are the second biggest mutual fund company behind Fidelity, I think American Funds are third.

John E. Cripe: Is there a break point?

Paul D. Lutomski: Not on the international, there is at $10 million on the total (stock index).

Dennis Duckworth: Yes, I'm just asking if there something else out there? We've limited ourselves to Vanguard and American. Maybe we shouldn't limit ourselves to just two groups.

John E. Cripe: We did a national RFP originally. When the plan gets to 30/70 I'm not opposed to another RFP, to see what else is available. It seems logical not to start over at this point. If we wait we may have opportunity losses greater than the fee. I'm sure we have had opportunity losses greater than the fee from the time in May when we first brought this up, to now. It didn't seem to make sense to go out and find a new ballpark, so to speak.

Georgia Glass: I think you make a valid point that we don't want to delay getting started while we go through an RFP process. Is there anyway to get started and do an RFP?

John E. Cripe: Well, you are dollar cost averaging.

Georgia Glass: So you have to commit?

John E. Cripe: So you have to know what the end goal is. That's why we put the same amount in each fund each month to gradually attain the 30/70 mix. Otherwise, if you play catch-up, you might be buying a lot at the wrong time.

Dennis Duckworth: The difference between waiting 6 months on one fund and doing it over an 18 month time period is probably inconsequential, or wait 3 months and do it over 21 months.

Paul D. Lutomski: I'll go out on a limb and say that if we find another company that provides this type of international index fund, or a combination of funds that would be equal, I would doubt if they would be any less than Vanguard. Vanguard has economies of scale because they are so huge.

Al McCray: They are the lowest cost by a long shot.

John E. Cripe: To move forward, since we have been here an hour and a half, I think it's important to know if you want a motion for us to move forward with our plan.

Al Townsend: I move that we proceed with the plan that was presented here.

Jim George: I'll second.

Dennis Duckworth: Any discussion?

Al McCray: I would like to say something.

John Cripe: (laughter) I've been waiting.

Al McCray: I don't have any problem with this. I think it should have happened long long ago, because the asset allocation was improper. I do want to caution you against going in with set dates to buy.

Paul D. Lutomski: How about 4 times a month?

Al McCray: I think you could do it every six months. You should have the flexibility to do it whenever you think its going to be profitable for you. If you see a large decline in the market, and you think that's the time to do it, go do it. We buy $300,000 to $500,000 at a time, usually on declines in the market. We are looking at stock prices this country has never seen before. I do want to caution you. If you think its going to continue that way I think you are wrong. You are not going to get 20% to 30% returns every year anymore in the United States common stock market. I also think you are going to incur larger potential fluctuations in asset values because common stocks have no protection of principle whatsoever. I agree with what you're doing as far as risk and return. The things that you've said are all true. I think going in and not placing a value on these securities before you make a purchase is the wrong way to do it. I also think you should look at cash flow. I don't know the cash flow that is needed for the pension, but you are going into common stocks that are going to be yielding about 1.8%. I hope you have the funds to make your retirement payments.

Paul D. Lutomski: Regarding cash flow, the answer for the next few months is easy. We are planing on selling Treasury STRIPs, to buy equities. The Treasury STRIPs have no cash flow and the equities will pay out no interest either. We have about $297,000 in monthly payments, $146,000 income from CMOs another $100,000 or so from employee contributions, quarterly interest from treasury bonds and the City's contribution. Eventually, if we sell t-bonds or agencies we will need other sources of cash. I'd like to see the pension increase its allocation of CMOs. The timing on those is so good. We are paid on the 17th and make payments at the end of the month. Right now we are maxed out on the amount of home loans we can own. I don't feel comfortable choosing individual corporate bonds. You have a whole staff that does that for you. If we were to do that we would need to buy a fund. Cash flow will be a concern in about 6 months or so.

Al McCray: I think you've done an excellent job over the years with your debt securities. Who knows whats going to happen in the stock market. I think you should be in international and domestic stocks.

Paul D. Lutomski: The plan is 60% domestic and 40% international.

Georgia Glass: Do you agree with the 60/40?

Al McCray: I think that if you are going to have stocks you have to have an international component, because the correlation of stock returns between any two countries is not positive. When one goes down the other goes up, but they all grow together in aggregate. I'm concerned with volatility and I'm concerned with the potential for decline. In 1973 the stock market fell 50%.

Aaron Drake: Look what bonds have done to us in the last three months.

Al McCray: It can happen.

Aaron Drake: We have the luxury of having a fund that will run to perpetuity, and when you look at average rate of return, stocks outperform bonds over the long term.

John E. Cripe: Our actuary looks at our funds over the long term. We don't have a crystal ball, and we try to make decisions that will make sense over the long term. The concept is that the plan should do better with this mixture than it would have done with the other mixture.

Paul D. Lutomski: Al, we discussed some of this over the telephone. The points you make are valid, and I want you to know that's why I thought to include the Ibbotson long term return figures with the real 5 year returns. I used an example where the Ibbotson long term return raises the average return where the fund had a negative 5 year return. For pretty much all the other funds the Ibbotson long term return is about half the last 5 year's return, so it brought the average down. I agree that the 5 year returns will not happen again. I don't think the 10 year return will be all that great.

Al McCray: . You have done a fine job with the portfolio given the constraints you had to meet.
I think your plan is fine and should have been should have been done a long time ago. I've stated my concerns and want to say again stress that you should the flexibility to invest whenever you think its going to be profitable for you. Not at a set time and dollar amount each month.

Aaron Drake: It's very hard to time the market.

Paul D. Lutomski: I'm not comfortable in trying to time the market. Studies have shown it can't be done with any consistency. If we try to do that everyone will be second guessing our timing decision, if we bought at the low price, etc.

John E. Cripe: Thank you for your confidence Al, but frankly we don't want the responsibility of timing the market. Maybe we would be successful, but maybe we wouldn't. It's a risk I don't think is worth taking. We have a motion on the table.

Dennis Duckworth: All in favor of the equity investment proposal?

All: Aye.

Dennis Duckworth: Motion carries.

Al McCray: How will your actuary feel when they find out the percentage of stock has increased? Will they assume more variability in earnings?

Paul D. Lutomski: I don't' think they will care. I can call and ask them.

Jim George: I have heard rumors of the pension being privatized? What can you (to John E. Cripe) tell me about that?

John E. Cripe: I can tell you I have heard nothing directly.

Georgia Glass: There is nothing solid on that.   Finance Director Don Herz has said he sees no gain from doing that. There is a meeting next week to discuss the pension. Mayor Wesely has invited the Police and Fire Union Presidents. Maybe we will know more after that.

John E. Cripe: The equity portion of the pension's assets are already under private management. Today's vote will put more assets under private management.

Jim George: Any news on the PEHP (post employment health plan)?

John E. Cripe: We are moving forward on that issue, and hope to get it in place before the calendar year end. Unions are available to join PEHP, but the management group must get IRS approval. Previously there was a concern that pension for Police and Fire would be lower due to the PEHP, but we can work around that so it wouldn't be lowered. The PEHP can be considered income for compensation purposes, but not lower your pension base salary.   I'd be glad to sit down and talk to you about it whenever is good for you.

Jim George: I'd also like to ask about the 26 pay period issue, and including your last paycheck into your base pay.

Georgia Glass: Call me and we can set up a time to talk about those three issues.

Dennis Duckworth: Any more items for discussion? Meeting Adjourned.